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No. 72-637

In the Supreme Court of the United States

OCTOBER TERM, 1972

KENNECOTT COPPER CORPORATION, PETITIONER

v.

FEDERAL TRADE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE FEDERAL TRADE COMMISSION IN OPPOSITION

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A-1-35) [1] is reported at 467 F.2d 67 and the opinions of the Federal Trade Commission (Pet. App. B-1-60) and the Initial Decision of the Hearing Examiner (Pet. App. C1-233) are not officially reported.

JURISDICTION

The judgment of the court of appeals (Pet. App. A-36) was entered on September 15, 1972, and rehear-

[1] "Pet. App." refers to the appendices to the petition for writ of certiorari. "App." refers to the joint appendix in the court of appeals.

ing was denied on October 13, 1972 (Pet. App. A37–38). The petition for writ of certiorari was filed on October 25, 1972. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and 15 U.S.C. 21(c).

QUESTIONS PRESENTED

1. Whether the Commission properly concluded that coal is a relevant product market and the nation as a whole is a relevant geographic market for purposes of assessing the competitive effects of the merger of a national coal company and a potential entrant into the coal industry.

2. Whether the elimination of the most likely entrant to a market with formidable entry barriers and a significant trend toward concentration may substantially lessen competition.

3. Whether the petitioner received a fair hearing in the Commission proceedings.

STATUTE INVOLVED

Section 7 of the Clayton Act, 38 Stat. 731, as amended, 15 U.S.C. 18, is set forth at Pet. 3.

STATEMENT

The petition seeks review of a unanimous judgment of the court of appeals (Pet. App. A1–36) affirming a unanimous decision of the Federal Trade Commission (Pet. App. B1–60) holding that the acquisition in 1968 by Kennecott Copper Corp. ("Kennecott") of the Peabody Coal Company ("Peabody") violated Section 7 of the Clayton Act.

A. THE ACQUIRING COMPANY

Kennecott, the nation's largest copper producer, has been engaged in the mining of copper and associated metals since it was formed in 1915. In 1966 it had sales of $739.7 million and net income of $125.4 million and ranked 55th in assets and 111th in sales in "Fortune's 500" list of United States industrial corporations (Pet. App. B–30).

The Commission found that Kennecott was engaged "in an extractive business with declining assets and mounting reserves of cash" (Pet. App. B–31). In mid-1966 it had about $150 million in cash and securities, expected to receive another $75 million from the sale of stock, and expected an additional cash flow of $467 million during the next 11 years (Pet. App. B–31). The copper industry did not provide an outlet for Kennecott's cash because the copper-ore content of deposits presently being mined is steadily diminishing (Pet. App. B–31), no substantial additional deposits have been found in the United States for more than 50 years, and foreign production is largely confined to politically unstable developing nations (Pet. App. C–85).

Kennecott's management was actively exploring ways to accomplish the "productive investment" of its surplus cash through diversification. As an initial step in the diversification program, in June 1965, Kennecott acquired the property of Knight-Ideal Coal Company ("Knight-Ideal") located in Carbon County, Utah (Pet. App. B–31). Subsequently, in late 1965,

Kennecott decided to enter the coal industry "one way or the other," either by internal expansion or acquisition of a going coal company (Pet. App. B–44–49, 50–51).

B. THE ACQUIRED COMPANY AND THE ACQUISITION.

At the time of its acquisition by Kennecott in 1968, Peabody was the largest coal company in the United States, with 1966 sales of $234 million and a net income of $26.3 million (Pet. App. B–31). It ranked 186th in assets and 317th in sales in "Fortune's 500" list for 1966 (Pet. App. B–32). Peabody operated approximately 37 mines in Alabama, Colorado, Illinois, Indiana, Kentucky, Missouri, Ohio, and Oklahoma, with additional operations planned for Arizona. As of mid–1967, it owned, leased or had under option more than 5.5 billion tons of proved recoverable coal reserves located in 14 states in different areas of the country. Peabody also owned, leased, had under option, or otherwise controlled substantial acreage in the West known to contain large amounts of coal, but which had not been fully explored or tested for mineability (Pet. App. B–32). Between 1955 and 1964, Peabody's sales of coal rose from 19 million to almost 60 million tons. This increase constituted about 45 percent of the nation's total expansion of coal production (Pet. App. B–37–40).

C. PROCEEDINGS BELOW.

The Commission issued its compliant on August 5, 1968, charging that the acquisition violated Section 7 of the Clayton Act because the acquisition eliminated

Kennecott as a substantial potential entrant into the production and sale of coal (Pet. App. B–1–14).

The Hearing Examiner concluded that coal (bituminous, sub-bituminous and lignite) is an appropriate line of commerce for testing the acquisition, and that Kennecott was a potential entrant into that market by acquisition. He ruled that the complaint should be dismissed, however, because Complaint Counsel had failed to prove any relevant geographic market. He also concluded that if the merger were evaluated in the national market for coal, it would not be anti-competitive because that market is not highly concentrated and numerous other companies are potential entrants (Pet. App. C).

The Commission adopted the Examiner's findings that coal is an appropriate line of commerce and that Kennecott was a potential entrant. It found, however, that the nation as a whole is a relevant geographic market, that this market is on the verge of being transformed into a tightly oligopolistic one, that concentration is more pronounced on a regional basis, that entry barriers are high and are becoming more formidable, and that there was no other firm which was as likely a potential entrant as Kennecott. The Commission concluded that the elimination of Kennecott as a potential competitor violated Section 7 and ordered divestiture of the acquired assets and business of Peabody (Pet. App. B–1–60).

The court of appeals unanimously affirmed the Commission's finding that Kennecott's acquisition of Peabody "may substantially lessen competition in the coal

industry" (Pet. App. A–24). The court of appeals, like the Commission, found that the "coal industry is a distinct submarket which has characteristics which are not shared by the other fuel industries" (Pet. App. A–23). The court of appeals also affirmed the Commission's findings that entry barriers to the market were "formidable," that Kennecott was the most likely entrant and that the company "exerted a substantial influence based on the likelihood of its entrance," that Kennecott's entry, via merger with Peabody, "eliminated a substantial potential competitive force," and that the combined financial resources of the merging companies resulted in a company with a real potential to accelerate "the already remarkable trend toward oligopoly" (Pet. App. A–24).

ARGUMENT

The Commission's decision is based upon factual findings under Section 7 of the Clayton Act which are fully supported by substantial evidence and which are the product of a fair hearing. The petitioner's contentions have been fully considered and correctly resolved by the court of appeals and no further review is warranted.

I. THE COMMISSION USED THE APPROPRIATE PRODUCT AND GEOGRAPHIC MARKETS IN DETERMINING THE COMPETITIVE EFFECT OF THE MERGER

The Commission found that coal is a relevant product market (Pet. App. B–33, 34). It pointed out that coal is "separate and distinct from other fuels, by virtue of the fact that coal has unique characteristics

which are commercially significant and a technology obviously different from such power sources as gas or nuclear energy" (Pet. App. B–4). The court of appeals upheld this determination, noting that (Pet. App. A–23):

> The coal industry is a distinct submarket which has characteristics which are not shared by the other fuel industries. It has shown its ability to maintain prices at a level which allows it to compete successfully against natural gas, its closest rival. Within its own ambit, however, its price structures are now, and promise to be in the future, subject to the peculiarities of the coal business. Thus, other fuels appear to have a limited effect.[2]

This determination constituted a proper application to the facts of this case of the criteria for determining relevant product markets announced in *Brown Shoe Co.* v. *United States,* 370 U.S. 294, 325.[3] There is no occasion for further review of this essentially factual determination.

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[2] Petitioner's contradictory assertions that the court of appeals "disagreed" with the Commission when it weighed the possible effects of competing fuels (Pet. 18) and that neither the Commission nor the court of appeals considered the effect of interfuel competition upon costs and prices (Pet. 19) are incorrect. The Commission and the reviewing court recognized the existence of competing fuels and both concluded that coal is a distinct product submarket with characteristics not shared by other fuels and that other fuels have a limited effect within the coal industry (Pet. App. A–23, B–6–7).

[3] Contrary to petitioner's claim, a staff report published by the Commission does not "highlight * * * [a] basic inconsistency in approach to this important sector of the nation's

Petitioner contends (Pet. 13, 14–20) that the decision below conflicts with *United States* v. *General Dynamics Corp.*, 341 F. Supp. 534 (N.D. Ill.), probable jurisdiction noted, December 11, 1972 (No. 72–402), where the district court held that coal was not a relevant market for determining the competitive effect of the merger between coal companies. The court there ruled (341 F. Supp. at 556) that "since coal competes with gas, oil, uranium and other forms of energy, the relevant line of commerce must encompass interfuel competition." In our jurisdictional statement in *General Dynamics,* we argued that that ruling is inconsistent with the standards of *Brown Shoe.*

Since the Court has noted probable jurisdiction in *General Dynamics,* that case will provide an opportunity for further clarification of the standard for determining appropriate product markets in Section 7 cases. There is no occasion for the Court also to con-

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economy" (Pet. 15). The document entitled "Economic Report: Interfuel Substitutability In The Electric Utility Sector of the U.S. Economy," by Thomas D. Duchesneau, essentially represents the views of one economist and, as the document states (p. iii), "the Commission has not accepted or adopted the report in whole or in part as its own." It does not purport to deal with the anti-competitive effects of a specific merger. The fact that an "energy market" undoubtedly exists and might be a relevant market for purposes of analyzing some mergers does not mean that the coal submarket is an inappropriate product market for purposes of this merger. See, *e.g.*, *Brown Shoe Co.* v. *United States*, 370 U.S. 294, 325, in which the Court said that well-defined submarkets may exist within a product market "which, in themselves, constitute product markets for antitrust purposes."

sider another case involving the same issue of market definition with respect to the same product, in which the court of appeals properly applied the correct standards.

The Commission also properly concluded that the United States as a whole is an appropriate geographic area in which to test the effect of the acquisition. Although high transportation costs limit the distance that coal can be economically shipped, the Commission found that the leading coal companies compete nationally, not only to obtain coal supply contracts, but also for acquisition of coal reserves (Pet. App. B–34–36). Peabody's existing mines and reserves were widely distributed in different parts of the country. Moreover, prior to its acquisition of Peabody, Kennecott intended to become a national producer of coal (Pet. App. B–36).[4]

[4] Petitioner relies upon a statement of an Assistant Attorney General, relating to a merger between an oil company and coal company, which was made five years before the Commission's ruling here, in support of its claim that the Commission erred in finding that for the purpose of considering the anti-competitive effect of this merger the entire country is a relevant geographic market. The letter of Assistant Attorney General Turner, concluding that "Continental [Oil] and Consolidated [Coal] were not significant competitors or potential competitors because they operated in different sections of the country and were unlikely to expand into one another's [territory]" (Pet. 18), is hardly relevant here. Compare *Federal Trade Commission* v. *Procter & Gamble Co.*, 386 U.S. 568, where, although Clorox was the only firm that sold nationally, and high shipping costs precluded bleach shipment beyond 300 miles from the point of manufacture, this Court recognized that the nation was a relevant geographic market. 386 U.S. at 571; see, also, *United States* v. *Pabst Brewing Co.*, 384 U.S. 546, 549–550.

II. THE COMMISSION PROPERLY CONCLUDED THAT THE EFFECT OF THE MERGER MAY BE SUBSTANTIALLY TO LESSEN COMPETITION BECAUSE IT ELIMINATED KENNECOTT AS A POTENTIAL ENTRANT INTO THE COAL BUSINESS

Congress was primarily concerned with preventing markets from reaching the "tight oligopoly" level (Pet. App. B–15) when it amended Section 7 in 1950. This Court in *Brown Shoe Co., supra,* 370 U.S. at 317–318, emphasized that:

> * * * [A] keystone in the erection of a barrier to what Congress saw was the rising tide of economic concentration, was its provision of authority for arresting mergers at a time when the *trend* to a lessening of competition in a line of commerce was still in its *incipiency.* Congress saw the process of concentration in American business as a dynamic force; it sought to assure the Federal Trade Commission and the courts the power to break this force at its outset and before it gathered momentum. [Footnote omitted; emphasis added.]

Potential competitors can break the force of a trend toward concentration by entering a market before it becomes a rigid oligopoly. They can also serve to ameliorate the effects of concentration as an external force influencing the conduct of firms within the market.[5] The effect of the elimination of a significant po-

[5] Petitioner incorrectly asserts that the government has maintained in previous potential competition cases that a highly concentrated market "is a necessary predicate for the conclusion that an elimination of a potential entrant may substantially lessen competition" (Pet. 14). Although the potential competition cases which this Court has considered have involved highly concentrated markets, the government has never sug-

tential entrant thus may be substantial to lessen competition, in violation of Section 7. *Ford Motor Co.* v. *United States,* 405 U.S. 562; *Federal Trade Commission* v. *Procter & Gamble Co.,* 386 U.S. 568; *United States* v. *Penn-Olin Chemical Co.,* 378 U.S. 158.[6]

The Commission found that the coal industry is experiencing an "alarming trend" toward high concentration (Pet. App. B–25). In *Brown Shoe Co., supra,* this Court found an incipient trend toward concentration in light of the fact that the top 24 manufacturers produced about 35 percent of the nation's shoes. 370 U.S. at 300. Concentration in the national coal market had progressed far beyond such an incipient level at the time this merger occurred. In 1967 the top 8 firms accounted for nearly 40 percent of total domestic coal production (Pet. App. B–40). The Commission also found that the level of concentration had been increasing rapidly. Between 1954 and 1967 the top four companies increased their share of production from 15.8

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gested and this Court has never held that the elimination of potential competition in a market which has not yet reached the "tight oligopoly" level (Pet. App. B–15) of concentration could not violate Section 7. In its brief in *United States* v. *Falstaff Brewing Co.*, No. 71–873, one of the briefs cited by petitioner (Pet. 14), the United States argued (p. 18): "In the beer industry, potential competition has particular significance. The market *trend* toward concentration in that industry has already been noted * * *. That *trend* alone suggests the importance of a potential entrant to the preservation of a competitive market structure." [Emphasis supplied.]

[6] Two cases involving the application of Section 7 to mergers that eliminate potential competition are pending before the Court. *United States* v. *First National Bancorporation, Inc.*, (71–703); *United States* v. *Falstaff Brewing Corporation* (71–873).

percent to 29.2 percent. During this period the market for coal expanded by 40.9 percent, but the share of the top four companies grew by 160.5 percent (Pet. App. B–2, 3, 38).

Contrary to petitioner's assertion (Pet. 22), the Commission did not rely solely upon past trends in finding that there is a substantial danger that the national coal market will become highly concentrated. Drastic changes in the pattern of coal usage since 1947, coupled with the huge increase in coal requirements of electric utilities caused by spiraling power demands, led it to conclude that large coal companies will continue to preempt most new business opportunities, and that smaller firms will in all likelihood be unable to arrest the trend toward concentration (Pet. App. B–3, 15–16).

The Commission not only found that Kennecott was the most likely potential entrant into the coal business but also found that entry barriers are high and are becoming "more formidable" (Pet. App. B–15, 41, 42). It noted that the increasing size of electric generating plants requires assemblage of "much larger coal reserves and operation of much larger mines * * *. The necessity of operating large mines requires the use of correspondingly large, sophisticated mining equipment which results in substantially greater capital requirements for the operation of a successful coal business * * *" (Pet. App. B–41, 42). Kennecott's Answering Brief also noted that large mines are necessary in order to utilize lower cost methods of trans-

portation and "'to take advantage of mechanization, particularly the employment of efficient and extremely expensive equipment'" (Pet. App. B–15, 16).

Such formidable entry barriers necessarily limit the possible entrants to companies such as Kennecott, which have both the necessary capital and a particular incentive to attempt to overcome those barriers. Kennecott had such an incentive because the copper industry does not provide an opportunity for the investment of the large cash surplus generated by Kennecott's operations (Pet. App. B–30, 31). The record does not indicate that any other company had a comparable incentive to enter the coal business.

Although Kennecott suggests that oil companies might enter the coal industry, Kennecott's expert witness, Dr. Fox, conceded that Kennecott was more closely related to coal than the oil companies (App. 3014–3015). None of the mining consultants and coal company witnesses who testified, except Kennecott officials, regarded any of the oil companies as a potential entrant into the business of producing and selling coal. A former Peabody president expressed his view that oil companies' interest in coal is aimed at liquefaction and gasification rather than the sale of coal as a fuel by itself (App. 1825–1826).[7] The record supports the commission's conclusion that Kennecott was

[7] He also testified that Humble's entry was probably motivated by a desire to obtain some coal mining experience so that "when they did get into mining synthetics, they would have a mining company of their own that they could mine the coal" (App. 1826).

the most likely entrant and may have been the only reasonably likely entrant.[8]

Kennecott's acquisition of Peabody not only eliminated the most likely entrant, but also created a further barrier to entry of any other company by making Kennecott's enormous cash surplus available to Peabody. Although Kennecott claims that its presence would not deter entry by companies with greater total assets or effect the competitive behavior of any existing coal company, it does not suggest that any of these companies had comparable quantities of surplus cash which could be utilized in competing for coal contracts and coal reserves.

The Commission's decision represents a rational exercise of the Commission's responsibility under Section 11 of the Clayton Act to utilize its administra-

[8] As a potential entrant, the Commission found, Kennecott had exerted a downward pressure upon the price of coal in Utah. In a pre-acquisition effort to dissuade Kennecott from entering the industry (App. 3631–33), Peabody offered to provide Kennecott with coal at a price substantially below Kennecott's then current coal cost (App. 3563). Thus Kennecott's influence on Peabody while at the edge of the market closely resembles that exerted by Pacific Northwest Pipeline Corp. upon El Paso Natural Gas Co. in *United States* v. *El Paso Natural Gas Co.*, 376 U.S. 651, 659. There, in order to forestall Pacific Northwest's attempted entry into the California market for natural gas, El Paso offered substantial price concessions to Southern California Edison Co. This Court stated with respect to this incident: "We would have to wear blinders not to see that the mere efforts of Pacific Northwest to get into the California market, though unsuccessful, had a powerful influence on El Paso's business attitudes within the state." 376 U.S. at 659.

tive expertize in breaking the force of a trend toward concentration.

III. THE COMMISSION DID NOT DENY PETITIONER PROCEDURAL DUE PROCESS.

Petitioner contends that the Commission denied it procedural due process in four respects. Contrary to those contentions, we submit that (1) the Commission's procedures do not violate due process, (2) the agency did not consider improper evidence, (3) Commissioner Jones did not prejudge the case, and (4) Kennecott was not denied the opportunity to demonstrate that it could not enter the coal industry by "toehold" acquisition.

1. It is well established that the combination of investigative and judicial functions within an administrative agency does not violate due process. *Pangburn* v. *Civil Aeronautics Board,* 311 F. 2d 349, 356 (C.A. 1), and cases cited; *Lehigh Portland Cement Co.* v. *Federal Trade Commission,* 291 F. Supp. 628 (E.D. Va.), affirmed, 416 F. 2d 971 (C.A. 4); see, also, *Richardson* v. *Perales,* 402 U.S. 389, 410; *Federal Trade Commission* v. *Cement Institute,* 333 U.S. 683, 700–703.[9] Congress has vested administrative agencies with both the specialized power to act in an accusatory capacity and the responsibility of ultimately determining the merits of the charge presented. *Federal*

[9] The Administrative Procedure Act permits such a combination of functions so long as the investigative and prosecutorial functions of the staff are separate from the process of decision by the agency. 5 U.S.C. 554(d).

Trade Commission v. *Cinderella Career and Finishing Schools, Inc.*, 404 F. 2d 1308, 1315 (C.A.D.C.).

2. The court of appeals properly concluded that charges that undue influence had been exerted upon the Commission through communications with members of Congress, the public and the Commission staff are unfounded. The court of appeals classified these exchanges as "routine communications" incidental to the Commission's responsibility to perform "certain public interest functions" (Pet. App. A–25, 26). The receipt of staff memoranda relating to a study of the energy industry was proper. The Commission is not barred from conducting a concurrent or subsequent adjudicatory proceeding simply because the Commission has dealt with similar matters in other investigations or proceedings. *Federal Trade Commission* v. *Cement Institute*, 333 U.S. 683, 700–703.

3. Petitioner alleges that certain statements made by Commissioner Jones showed that she had prejudged the case and that her disqualification was therefore required. The argument was thoroughly considered in the opinion of the court of appeals upon which we rely. As the court of appeals held (Pet. App. A–27):

> We have examined the cases [cited by petitioner] and in each instance in which the courts considering the facts have ruled that the Commissioner had to be disqualified, action was entirely justified based on comments showing what appeared to be a prejudice or a viewpoint. No such commenting or editorializing is present here. From a reading of the statement

> in its entirety, it is clear that Commissioner Jones was discussing the *complaint* and was doing so in an effort to illustrate a point. Thus, it does not appear that she stepped over the line, whereby she showed even a slight commitment. For this reason, we hold that the expressions do not violate the standard set forth in the cases.

See, also, *Federal Trade Commission* v. *Cement Institute*, 333 U.S. 683, 702–703.

4. Petitioner contends that the Commission had denied Kennecott a fair hearing by relying upon the "toehold" acquisition theory—i.e., that Kennecott was likely to have acquired a small firm—"when that theory had not been litigated" (Pet. 28). This contention apparently relates to the Commission's rejection of the Hearing Examiners' conclusion that the legality of the merger depended on a finding that Kennecott was a potential entrant by internal expansion (Pet. App. 21–25). The Commission held that if Kennecott was a potential entrant through acquisition of a smaller coal company, one not occupying as significant a place in the market as Peabody, then its entry via acquisition of "the leading company" in the coal industry tended substantially to lessen competition (Pet. App. B–25–26). The Commission found that (Pet. App. B–26): "While Kennecott was able to enter the industry [through a toehold acquisition] and thus add substantial competition, it eliminated this competition by acquiring Peabody."

Contrary to petitioner's claim, the Commission's reliance on the "toehold theory did not deprive it of"

a fair hearing. The complaint alleged that the merger eliminated "potential competition" (App. 9); this allegation necessarily includes the possibility of potential competition through *de novo or* toehold entry. Moreover, the entry-by-acquisition issue was fully litigated. The complaint alleged that Kennecott "explored the possibility of acquiring certain local and regional coal companies" (App. 4), the record contains evidence that Kennecott did negotiate with a smaller coal company (App. 2736–2737, 2842), the examiner found that Kennecott was a potential entrant by acquisition of a going company, and Complaint Counsel argued before the Commission that "Kennecott was indeed a potential entrant by acquisition * * *" (App. 3127).[10] The Commission's finding that Kennecott was a potential entrant by toehold acquisition did not deprive petitioner of a fair hearing.[11]

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[10] Complaint counsel did state in response to a question that "[w]e didn't make any charge that Kennecott was a potential entrant by acquisition" (App. 3127). Since he also argued that Kennecott was a potential toehold entrant, this statement cannot properly be viewed as a disavowal of a toehold theory.

[11] *Bendix Corp.* v. *Federal Trade Commission*, 450 F. 2d 534 (C.A. 6), cited by petitioner (Pet. 28), does not hold otherwise. In *Bendix* the court of appeals found that the potential competition charge in the complaint had been limited to *de novo* entry by a subsequent statement of issues, 450 F. 2d at 535, 541, and concluded that Bendix should be permitted to introduce additional evidence because it may have been misled by this limitation of issues. No such limitation occurred in this case.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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